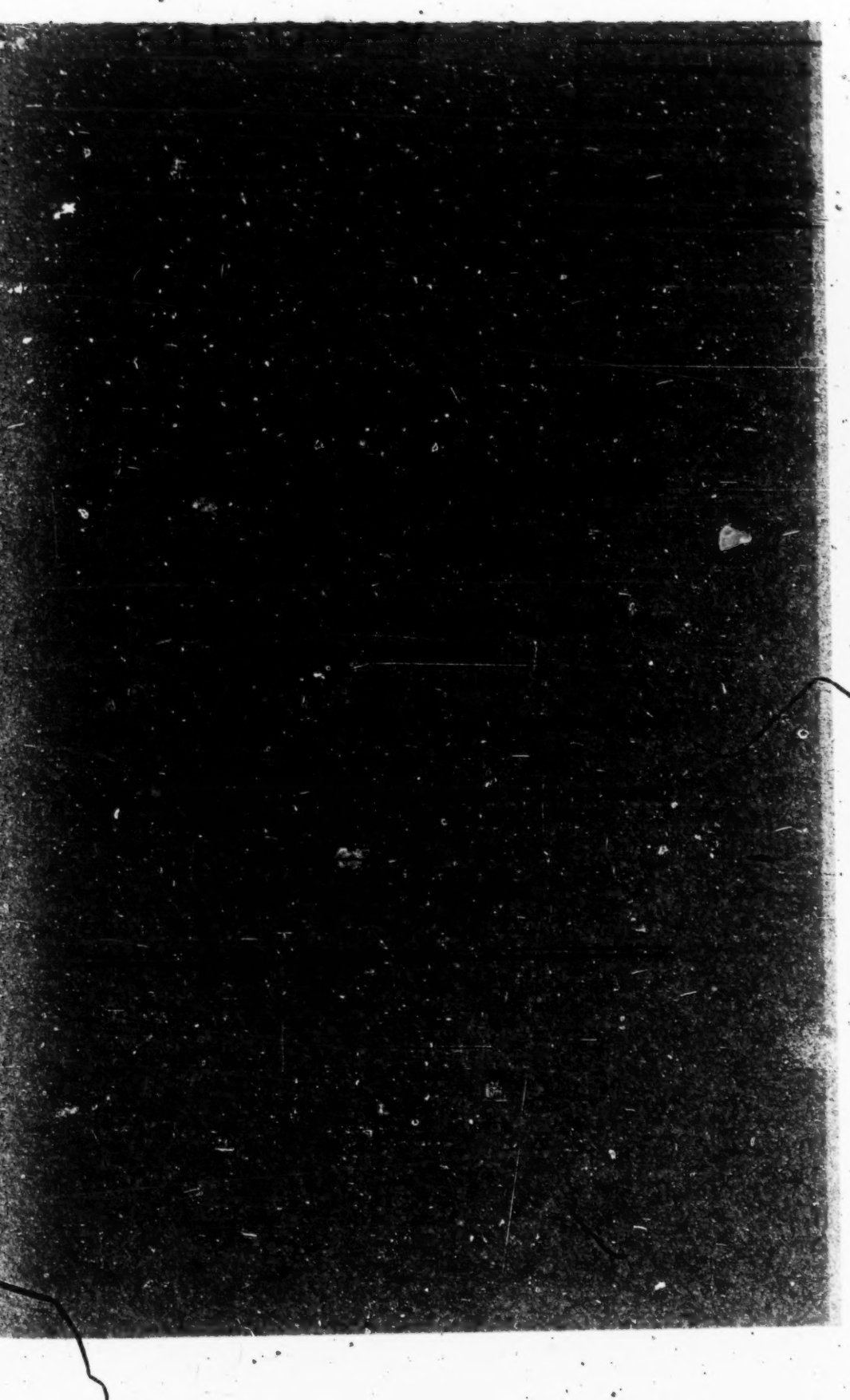

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 180

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

DONALD H. OWENS AND MARION HAVILAND OWENS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 6–9) is unreported. The opinion of the Circuit Court of Appeals (R. 15) is reported in 95 F. (2d) 318.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 14, 1938 (R. 17). On June 2, 1938, the time within which a petition for a writ of certiorari could be filed was extended for a period

of sixty days from June 7, 1938 (R. 17). The petition for a writ of certiorari was filed on July 6, 1938, and was granted on October 10, 1938 (R. 17). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the basis for determining the amount of a loss "sustained during the taxable year," through an accident to property which is not used in a trade or business and is not subject to an annual depreciation allowance, should be the value immediately before the accident or the original cost.

STATUTES AND OTHER AUTHORITIES INVOLVED

The applicable portions of the pertinent statute and the other authorities involved will be found in the Appendix, *infra*, pp. 23–32.

STATEMENT

The Board of Tax Appeals, in adopting the stipulated facts, made substantially the following findings (R. 17):

The respondents are husband and wife. Prior to January 1, 1934, but after March 1, 1913, the respondent Donald H. Owens purchased an automobile at a cost to him of $1,825. The automobile at all times since has been, and was until June 1934, used by him for his personal use only, and not in connection with any trade or business carried

on by him. In June 1934, by reason of an accidental collision with another automobile, the automobile was wrecked and partly demolished. It thereafter had a fair market value of $190. Immediately prior to such collision, the automobile had a fair market value of $225. No insurance was carried on the automobile and no compensation through insurance or otherwise has been received for any part of the loss sustained by reason of the accident (R. 7).

The respondent and his wife filed a joint income tax return for the calendar year 1934. No deduction on account of depreciation of the automobile was claimed or allowed during any taxable year. In the return for 1934, filed by the respondents, a loss deduction was claimed in the amount of $1,635, being the difference between the cost and the salvage value of the automobile immediately after the accident. The Commissioner allowed a deduction in the amount of $35, representing the difference between the fair market value of the automobile immediately prior to the accident and its salvage value immediately after the accident (R. 7).

The Board held that the deduction, as claimed by the respondents, should be allowed and determined that there was no deficiency in respondents' income tax for the year 1934 (R. 9).

The Circuit Court of Appeals affirmed the Board's decision (R. 16).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In failing to hold that the amount of the deduction allowable to the respondents for the loss of their automobile which was used for personal purposes is the difference between the fair market value of the automobile immediately before the accident and its value thereafter, and in holding that the basis for determining the amount of the loss is the original cost.

2. In affirming the decision of the Board.

SUMMARY OF ARGUMENT

The Government's position is that the loss deductible by reason of casualty is the amount of the loss resulting from the casualty; namely, the difference between the value of the automobile immediately before and that immediately after the collision. This position has been approved by the Circuit Court of Appeals for the Fourth Circuit in its recent decision in *Helvering* v. *Obici*, 97 F. (2d) 431, now pending on writ of certiorari in this Court, No. 318, present Term. The decision of the court below allowing a deduction of $1,635, measured by the difference between original cost and value after the collision, does violence to the provision of the Revenue Act of 1934 permitting a deduction under these circumstances and to settled provisions of the Revenue Acts.

Section 23 (e) (3) of the Revenue Act of 1934 allows the deduction of a loss sustained during the

taxable year if the loss arises from fires, storms, shipwreck, or other casualty. In the present case the loss from the casualty was $35, the additional $1,600 allowed by the court below representing the loss due to depreciation, the greater part of which occurred in previous years. The Revenue Acts have allowed deductions only for actual losses, and those only when sustained. An offset of losses sustained in other years against income of the taxable year is permissible only when specifically allowed. The decision below also grants a deduction for depreciation of non-business property which is denied by other provisions of the statute, and treats as the basis for determining the casualty loss the cost of property which was not the property suffering the damage. On the other hand, the use of value immediately prior to the collision resolves all of these inconsistencies.

The court below erroneously held that unadjusted cost must be used as the basis, on the ground that Section 23 (h) of the statute provides that the basis for losses shall be the adjusted basis prescribed in Section 113 (b), which in turn, in subdivision (1) B, provides that proper adjustment to cost shall in all cases be made for depreciation and other deductions, to the extent allowed (but not less than the amount allowable), and that since no such deductions are allowed or allowable in respect of non-business property, no adjustment of cost could be required in fixing the basis. Section 23 (h) necessitates the use of an adjusted basis, not cost, the un-

adjusted basis. Section 113 (b) is applicable to many other types of transactions in addition to casualty losses to non-business property, including gain or loss on the sale of property, losses incurred in trade or business, losses incurred in transactions entered into for profit, and corporate losses. Section 113 (b) (1) B will still have substantial application if, as we contend, the limitation on adjustments contained in that subdivision is construed to apply to situations where such adjustments represent allowable or allowed deductions, but not to apply where no such deductions are allowed, and in such case a reasonable adjustment for depreciation must be made. The use of value before the accident approximates cost less the reasonable adjustment for depreciation. If Section 113 (b) (1) B should nevertheless be deemed to apply in the case of non-business losses, it is limited by Section 23 (e) (3), and merely establishes a maximum beyond which the basis shall not rise, but not the minimum, where to so apply it would allow a deduction in excess of the loss from casualty, contrary to the legislative intent.

Prior decisions of this Court illustrate the principle that the basis provisions of the Revenue Acts are not inflexible and all-inclusive, but must be read in connection with the particular situation disclosed and the legislative intent as a whole. The regulations have never contained specific provisions with respect to non-business property as to which no

deductions for depreciation were allowed. The decisions and the administrative rulings have not been consistent and cannot be said to have prescribed a uniform rule. The final ruling of the Bureau of Internal Revenue, embodied in G. C. M. 16255, XV-1 Cumulative Bulletin 115, and the decision in the *Obici* case represent the reasonable and correct construction of the statute.

ARGUMENT

THE ONLY LOSS DEDUCTIBLE IS THAT ACTUALLY SUSTAINED DURING THE TAXABLE YEAR, WHICH IS CORRECTLY MEASURED BY THE DIFFERENCE BETWEEN THE VALUE OF THE AUTOMOBILE JUST BEFORE AND THE VALUE JUST AFTER THE ACCIDENT

The facts of this case can be simply stated. The respondent Donald H. Owens was the owner of an automobile, which had cost him $1,825. In June 1934 it had a value of $225. In that month it was damaged by a collision, as a result of which its value was decreased to $190. It is the Government's position that respondent is entitled to a deductible loss in the amount of $35, the difference between the value of the automobile just before and that just after the collision. This position has been approved in a similar case by the Circuit Court of Appeals for the Fourth Circuit. *Helvering* v. *Obici*, 97 F. (2d) 431, pending on writ of certiorari, No. 318, assigned for argument immediately following the present case. The respondent, on the other hand, claims a deductible

loss in the amount of $1,635, the difference between the original cost and the value after the collision. This position was approved by the Board and the court below.

The decision of the court below, we submit, does violence to the provision of the Revenue Act of 1934 permitting a deduction in these circumstances, and to settled principles embodied in all the Revenue Acts. Section 23 (e), *infra*, p. 23, allows as deductions "losses sustained during the taxable year and not compensated for by insurance or otherwise," including (paragraph 3) losses "of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft." The decision below has allowed as a deduction a loss which did not actually arise from casualty, and has allowed it in a year during which it was not sustained. The loss from casualty was a loss in value of $35. The additional $1,600 which respondent seeks to deduct represents a loss due to depreciation, a loss, moreover, which occurred not during the taxable year but over a previous period of years. It has been the settled policy of the Revenue Acts to allow as a deduction for losses only an actual loss, and to allow that only in the year when sustained. Cf. *United States* v. *White Dental Co.*, 274 U. S. 398; *Lucas* v. *American Code Co.*, 280 U. S. 445, 449; *U. S. Cartridge Co.* v. *United States*, 284 U. S. 511, 520; *Burnet* v. *Huff*, 288 U. S. 156; *Gowen* v. *Commissioner*, 65 F. (2d)

923, certiorari denied, 290 U. S. 687; *DeLoss* v. *Commissioner*, 28 F. (2d) 803 (C. C. A. 2d), certiorari denied, 279 U. S. 840; *Lewellyn* v. *Elec. Reduction Co.*, 275 U. S. 243. Income of one year cannot be offset by losses sustained in another year, except in those unusual situations where the statute specifically authorizes such an offset. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363; *Burnet* v. *Thompson Oil & G. Co.*, 283 U. S. 301, 306; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326.

Furthermore, the decision below permits a deduction for depreciation in the case of non-business property although such a deduction is not allowed by the statute. The Revenue Act of 1934, Section 23 (l), *infra*, p. 24, permits as a deduction a reasonable allowance for the exhaustion, wear and tear of property "used in the trade or business." The regulations provide specifically that "The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, * * *" Regulations 86, Article 23 (l)–2. And Section 24 (a) of the Act, *infra*, p. 24, provides that in computing net income no deduction shall in any case be allowed in respect of personal, living, or family expenses. The Revenue Acts have consistently refused the allowance of deductions for depreciation of property not used in the trade or business. See *F. M. Hubbell Son*

& Co. v *Burnet*, 51 F. (2d) 644 (C. C. A. 8th), certiorari denied, 284 U. S. 664. Deductions for depreciation are allowable only where specifically provided, and only in the years when sustained. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 306; *Kittredge* v. *Commissioner*, 88 F. (2d) 632 (C. C. A. 2d).

Finally, the decision below treats as the basis for determining the deductible loss the cost of property which was not the property suffering the damage by casualty. The property here involved is depreciable property. It was not the same just prior to the collision as it was at the time of purchase. This principle was concisely stated by the Court in *United States* v. *Ludey*, 274 U. S. 295, 301:

> When the plant is disposed of after years of use, the thing then sold is not the whole thing originally acquired. The amount of the depreciation must be deducted from the original cost of the whole in order to determine the cost of that disposed of in the final sale of properties. Any other construction would permit a double deduction for the loss of the same capital assets.

What was said in the *Ludey* case is applicable, *mutatis mutandis*, to the case at bar. The amount of depreciation of the automobile must be subtracted from the original cost in order to determine the cost of what has been subjected to loss. The construction adopted by the court below would permit a deduction for the loss of property by depreciation

where it has not been allowed by statute; would allow the unauthorized deduction in a year when that loss was not sustained; and would treat as the basis for determining loss the cost of property which was not the property suffering the damage by casualty.

A result so at odds with the basic principles of the Revenue Acts can be supported only if plainly compelled by the terms of the statute. Cf. *Mitchell v. Commissioner*, 48 F. (2d) 697, 700 (C. C. A. 2d), certiorari denied, 284 U. S. 646. The court below thought that the result was compelled by the provisions setting forth the basis to be used in determining gain or loss. Section 23 (h), *infra*, p. 23, provides that the basis for determining the amount of deduction for losses sustained shall be the adjusted basis provided in Section 113 (b) for determining the loss from the sale or other disposition of property. Section 113 (b), *infra*, p. 24, provides a so-called adjusted basis for determining gain or loss from the sale or other disposition of property. This basis is defined as cost adjusted, *inter alia*, for (paragraph B) "exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws * * *." The court below reasoned that since no exhaustion, wear and tear, or obsolescence was allowed or allowable in respect of non-business property under the statute, the ad-

justed basis in Section 113 (b), specifically made applicable to the facts of the present case by Section 23 (h), was in fact the same as the unadjusted basis provided in Section 113 (a), namely, the cost of the property damaged.

If the result thus reached by the court below were as plainly required by the terms of the basis provisions as the court felt it to be, the result would still be questionable because it fails to take into account other provisions of the statute, discussed above, which deny a deduction for depreciation in the case of non-business property, and which limit losses to those actually sustained in the taxable year. As was said in *Helvering* v. *Morgan's, Inc.*, 293 U. S. 121, 126:

> But the true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part.

A construction is to be avoided which will result in inconsistencies among the provisions of the Act. "Effect must be given to all the language employed, and inconsistent expressions are to be harmonized to reach the real intent of the legislature." *Iglehart* v. *Iglehart*, 204 U. S. 478, 485.

But it is submitted that the provisions setting forth the basis for determining gain or loss do not

require the result reached by the court below. It will be observed that Section 113 (a) refers to an "unadjusted" basis, namely cost, while Section 113 (b) prescribes the use of an "adjusted" basis. Obviously a significant distinction was intended between the two. The Revenue Act of 1932, Section 113 (b) (c. 209, 47 Stat. 169, 201) first provided for an *adjusted basis*. The provision was inserted in that form to clarify the rule which might not have been plain in all situations under previous Acts and to remove any doubts that upon the sale or other disposition of property the basis should be the net capital investment in the property at any point of time when it should become material to determine gain or loss, depreciation, or other deductions. See H. Rep. No. 708, 72d Cong., 1st Sess., pp. 18–19; S. Rep. No. 665, 72d Cong., 1st Sess., pp. 24–25. It is the provision for adjusted basis in Section 113 (b) which is made applicable by Section 23 (h) to losses of the character here involved. Yet the decision below makes applicable, in effect, the provision for unadjusted basis in Section 113 (a).

Moreover, the method by which the cost basis is to be adjusted, as provided in Section 113 (b) (1) (B), is not necessarily the method to be applied in the case of non-business property. The provision in question is applicable, it will be observed, to a large variety of losses, including losses to business property from casualty, losses in transactions en-

tered into by individuals for profit, and losses suffered by corporations. This is true because Section 23 (h) makes the adjusted basis applicable in determining deductions for losses sustained in all classes of cases under subsection (e) or subsection (f) of Section 23. Furthermore, it is applicable in all cases of gain or loss from the sale or other disposition of property. Consequently Section 113 (b) (1) (B) will have substantial scope if it is not literally applied to losses to non-business property. In this view the paragraph defines the measure of the adjustment for depreciation where the measure might be the amount allowed or the amount allowable; the paragraph makes clear which of these two is to be used. The paragraph does not constitute the authority for the adjustment; the authority is to be found in Section 23 (h) and Section 113 (b), which require that the basis shall be an "adjusted" basis. In the case of losses by casualty to non-business property, we suggest that the precise method of adjustment has not been provided, and that Section 23 (h) and Section 113 (b) read together merely require that the basis be cost reasonably adjusted. In this view the basis would be the value of the property at the time of the casualty, which approximates the depreciated cost of the property.

If Section 113 (b), (1) (B) is nevertheless deemed to govern the present case, it does not require the incongruous deduction allowed by the court below. In view of Section 23 (e) (3), confining deductible losses to those actually sustained,

the provisions of Section 113 (b) (1). (B) should be construed as establishing only a maximum figure beyond which the basis may not rise, but not establishing cost as a basis where to allow it would be to permit a loss in excess of that sustained and to allow a deduction elsewhere specifically denied. In other words, that paragraph requires that exhaustion, etc., be deducted from cost to the full extent allowed, or to the full extent allowable, whichever is greater; but it does not eliminate the necessity of subtracting depreciation in the case of non-business property where depreciation is neither allowed nor allowable under the Act. Nor does it require the use of cost of property other than that suffering the casualty.[1] Our interpretation prohibits the taxpayer from deducting as a loss more than the cost of his property, and does not permit him in all cases to deduct as much as the cost. If the actual loss is less than cost, he is limited to the amount of the actual loss as a deduction, where no previous deductions were allowable, in conformance with the legislative intent. This construction is that adopted by the Treasury Department. See G. C. M. 16255, XV–1 Cumulative Bulletin 115.

[1] So in *Heiner* v. *Tindle*, 276 U. S. 582, under a statute which required March 1, 1913, value as the basis, this Court adopted value as of 1901, which date marked the change from residential to commercial uses and accordingly brought the property for the first time within the purview of the deduction provisions of the Revenue Acts.

The use of value at the time of the casualty as a basis is in accord with the intent of the statute considered as a whole. It allows the deduction of the actual loss when sustained, it prohibits the deduction of losses suffered in other years, and it avoids the inconsistency of allowing deductions for losses which by another provision of the statute are specifically denied. Such a construction does no violence to the statutory language.

The decisions of this Court in analogous cases indicate the soundness of the Government's position. The provisions of the revenue acts which set forth the basis for determining gain or loss have on occasion been relied on as an inflexible and all-inclusive formula, without regard to the circumstances of the case and the other provisions of the act. Such a view of the basis provisions has been repeatedly rejected by this Court.

In *United States* v. *Flannery*, 268 U. S. 98, the taxpayer bought certain stock prior to March 1, 1913, and sold it in 1919 for more than its cost but for less than its value on March 1, 1913. The Revenue Act of 1918, which was applicable, provided that for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property the basis should be, in the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date. The taxpayer, resting his argument firmly upon the basis provisions, contended that he

was entitled to deduct a loss in the amount of the difference between the March 1, 1913, value and the sale price. This Court held, however, that the basis provisions were merely a limitation on the amount of gain or loss taxable or deductible, and that there must be an actual loss before the basis provisions for determining losses could be brought into play.

A similar problem was presented in *McCaughn v. Hollingsten*, 268 U. S. 106. In that case stock was bought prior to March 1, 1913, and was sold thereafter at a price which was less than either its original cost or the March 1, 1913, value. The March 1, 1913, value was, however, the higher figure, and the taxpayer sought to use it under the basis provisions of the Revenue Act of 1918, just described. In this case there was no question that an actual loss had been sustained, and it may have been supposed that the basis provisions must be literally applied as the taxpayer insisted. This Court held, however, that the case was governed by the decision in the *Flannery* case. The taxpayer was held entitled to deduct only his "actual loss," the difference between the purchase and selling prices, even though the Revenue Act prescribed the March 1, 1913, value as the basis.

United States v. *Ludey*, 274 U. S. 295, also indicates that the basis provisions must be construed in relation to other relevant provisions and to the underlying principles of the taxing Act. The Revenue Act of 1916, there involved, provided that the

basis for determining gain or loss on the sale of property acquired prior to March 1, 1913, should be its value as of that date, and no provision was made for adjusting the cost or March 1, 1913, value on account of depreciation or depletion. The taxpayer sold certain oil mining properties at less than original cost or the March 1, 1913, value. The taxpayer accordingly claimed a deductible loss. The Commissioner, however, insisted that the cost basis must be adjusted on account of depreciation and depletion, and that when such adjustment was made a gain on the sale was shown. This Court held that, despite the fact that the basis provisions did not provide for the deduction of depreciation and depletion from cost, such an adjustment must nevertheless be made. The Court stated (p. 300) that "Congress, in providing that the basis for determining gain or loss should be the cost or the 1913 value, was not attempting to provide an exclusive formula for the computation."

It is true that in the *Ludey* case the amount of depreciation and depletion required to be deducted from cost was not the full amount sustained but only that allowable by law as a deduction from gross income in past years. The reason given for adopting this measure was that Congress doubtless intended that the deduction to be made from original cost should be the aggregate amount which the taxpayer was entitled to deduct as a depreciation allowance (274 U. S. at 304). This aspect of the decision was further explained in *Burnet* v. *Thomp-*

case *Oil & Gas Co.*, 283 U. S. 301, 306-307, on the ground that an adjustment exceeding the amount allowable would tax more than the actual gain derived and have the effect of taxing in part a return of capital. Neither of these considerations is applicable in the case at bar. Here it is clear from other provisions of this and prior Acts that Congress intended to allow no deduction for depreciation; and the question whether more than actual gain is taxed has no bearing, since we are dealing not with a gain but with a deductible loss, a matter of legislative grace.

The foregoing decisions go far to suggest the sound result in the present case. They warn against a reading of the basis provisions as an all-inclusive formula for determining losses, and they are a reminder that those provisions are designed to implement the controlling provisions which permit deductions only for losses actually sustained, arising from the events enumerated, and suffered in the taxable year.

With respect to the precise issue here presented, the decisions and the administrative rulings as well have not been consistent, and accordingly cannot be said to have prescribed a uniform rule. In some cases a basis other than cost was used;[2] in others

[2] *Webb* v. *Commissioner*, 1 B. T. A. 759; *Shearer* v. *Anderson*, 16 F. (2d) 995 (C. C. A. 2d) [deductible loss measured by the cost of repairs]; *Buckwalter* v. *Commissioner*, 20 B. T. A. 1005, affirmed on other points, 61 F. (2d) 971 (C. C. A. 6th) [difference between the value at the time of

cost was adopted.[1] The Board of Tax Appeals has followed the latter view in the present case and in *Helvering* v. *Obici*, *supra*.

The regulations have never contained specific provision with respect to non-business property as to which no deductions for depreciation were allowable. Article 141, Regulations 45, promulgated under the Revenue Act of 1918, provided generally as to casualty losses that the basis should be cost adjusted by the amount which had been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation. Article 141, Regulations 62, promulgated under the Revenue Act of 1921, provided that the deduction for casualty loss should be the difference between the cost of the property, less proper adjustments for depreciation, and the salvage value. Article 141, Regulations 65, promulgated under the Revenue Act of 1924, provided generally as to all losses that the basis should be the same as that for gain or loss upon sale, with

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the casualty and the salvage value]. Cf. *Grant* v. *Commissioner*, 30 B. T. A. 1028, where an arithmetical formula based upon cost and value prior to and after the casualty was used.

[1] *Brooks* v. *Commissioner*, 12 B. T. A. 31, affirmed on other grounds, 35 F. (2d) 178 (C. C. A. 4th); *O'Rear* v. *Commissioner*, 28 B. T. A. 698, 701, overruling *Buckwalter* v. *Commissioner*, *supra*, affirmed on this point in *O'Rear* v. *Commissioner*, 80 F. (2d) 473 (C. C. A. 6th), on the ground that the question was not properly raised before the Board of Tax Appeals. Cf. *Bass* v. *Commissioner*, 30 B. T. A. 4.

proper adjustment for items of loss, depreciation, obsolescence, amortization or depletion previously allowed with respect to the property. Article 141, Regulations 69, promulgated under the Revenue Act of 1926, provided that the basis for losses should be the same as that for gain or loss upon sale, with proper adjustment for depreciation, obsolescence, amortization or depletion, the proper adjustment being defined by reference to Article 1561 as the amount which had been allowed since the acquisition of the property, whether or not such deductions were claimed by the taxpayer or formally allowed. Similar provisions are contained in Article 171 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively, and Article 23 (h)–1 of Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936, respectively.

The administrative rulings have varied. I. T. 1567, II–1 Cumulative Bulletin 90, did not specifically rule on the subject, holding merely that a claimed loss through depreciation of land due to the action of the sea was merely conjectural and indeterminate and could not be deducted as a casualty loss. I. T. 2217, IV–2 Cumulative Bulletin 53, ruled that upon the destruction of a residence by fire undepreciated cost formed the basis for the deductible loss, since the taxpayer had not been permitted to deduct depreciation in prior years. This ruling was followed in I. T. 2231, IV–2 Cumulative Bulletin 53. These rulings were disapproved by

G. C. M. 16255, XV–1 Cumulative Bulletin 115, holding that the deductible loss from casualty to non-business property is the difference between the value immediately before and immediately after the casualty, and I. T. 2217 and I. T. 2231 were modified accordingly by I. T. 2966, XV–1 Cumulative Bulletin 299. This is the present position of the Treasury Department.

For the reasons advanced heretofore, we submit that the final ruling of the Commissioner in G. C. M. 16255, *supra*, and the decision of the Circuit Court of Appeals for the Fourth Circuit in *Helvering* v. *Obici*, *supra*, represent the reasonable and correct construction of the statute.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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NOVEMBER 1938.

APPENDIX

STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 690:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

* * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(h) *Basis for determining loss.*—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property.

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * * [U. S. C., Title 26, Sec. 23.]

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * * *

[U. S. C., Title 26, Sec. 24.]

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) * * * [U. S. C., Title 26, Sec. 41.]

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the

amount allowable) under this Act or prior income tax laws. * * * [U. S. C., Title 26, Sec. 113.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (e)—1. *Losses by individuals.*—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (*d*) if not prohibited or limited by any of the following sections of the Act: Section 23 (g), relating to wagering losses; section 24 (a) (6), relating to losses from sales or exchanges of property between members of a family or between a corporation and its shareholders; * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. (See section 113 (b).)

A loss occasioned by damage to an automobile maintained for pleasure, where such damage results from the faulty driving of

the taxpayer or other person operating the automobile, but is not due to the willful act or willful negligence of the taxpayer, is a deductible loss in the computation of net income. If damage to a taxpayer's automobile results from the faulty driving of the operator of an automobile with which the automobile of the taxpayer collides, the loss occasioned to the taxpayer by such damage is likewise deductible. No loss is realized by the transfer of property by gift or by death. But see section 44 (d).

A loss on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible. * * *

ART. 23 (b)-1. *Basis for determining loss.*—The basis for determining the amount of the deduction for losses is the same as is provided in section 113 for determining the loss from the sale or other disposition of property. Proper adjustment must be made in each case for any expenditure, receipt, loss, or other item properly chargeable to capital account, and for depreciation, obsolescence, amortization, or depletion. (See section 113 (b).)

ART. 113 (b)-1. *Adjusted basis: General rule.*—* * *

* * * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1934 or prior income tax

laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. * * *

G. C. M. 16265, XV-1 Cumulative Bulletin 115-118:

SECTION 23 (e).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY INDIVIDUALS.

ARTICLE 23 (e)-1: Losses by individuals.

REVENUE ACT OF 1934

* * * * *

Advice is requested relative to the determination of the amount of the loss deductible under the provisions of section 23 (e) 3 of the Revenue Act of 1934 where an automobile purchased for the taxpayer's personal use was damaged in a collision.

In the year 1929 the taxpayer purchased an automobile for his personal use at a cost of 7x dollars. In the year 1934 he had a collision, not due to his own recklessness, at which time he carried no collision insurance. Just prior to the collision the automobile had been appraised for trade-in purposes at 3.60x dollars. After the collision the car

was limited to but the allowance was only [illegible] dollars.

Section 23 (e) 2 of the Revenue Act of 1934 provides that in computing the taxable net income of an individual there shall be allowed as a deduction losses sustained during the taxable year and not compensated for by insurance or otherwise of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. In interpreting the corresponding section of prior Revenue Acts, it has been held that a loss resulting from an automobile collision, where such accident was not due to the wilful act or wilful negligence of the taxpayer, is deductible as a loss arising from "other casualty" (*Shearer v. Anderson*, 10 Fed. (2d), 965; *W. S. Brunson v. Commissioner*, 2 B. T. A. 1008, acquiescence, C. B. VIII-1, 6; *Tracy V. Batchelder v. Commissioner*, 20 B. T. A., 1005; I. T. 2408, C. B. VI-1, 85; and article 23 (e)-1 of Regulations 86).

Section 23 (h) of the Revenue Act of 1934 provides that the basis for determining the amount of deduction for losses sustained, to be allowed under section 23 (e) of that Act, shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property. Under the provisions of section 113 (b) of the Revenue Act of 1934, the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, with certain exceptions inapplicable in the instant case, is the cost of such property, diminished as provided by section 113 (b) 1 (B) for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less

than the amount allowable) under that Act or prior income tax laws.

In *Tracy F. Buchwalter* v. *Commissioner*, supra, the Board of Tax Appeals allowed as a deduction in the case of an automobile damaged by fire in 1927 only the difference between the actual value immediately prior to the fire and the salvage value.

In *Heiner* v. *Tindle* (276 U. S. 582), arising under the Revenue Act of 1918, the taxpayer built a residence in 1888, used it as a residence until 1901, and leased it beginning in 1901 until he sold it in 1920. The United States Supreme Court held that there occurred in 1901 a transaction entered into for profit, and since the fair market value of the property on March 1, 1913, was less than the value in 1901, and less than actual cost, the taxpayer sustained a deductible loss of the difference between the March 1, 1913, value and the selling price.

In *Mitchell* v. *Commissioner* (48 Fed. (2d), 697, certiorari denied, 284 U. S., 646), the Circuit Court of Appeals for the Second Circuit said in a case arising under the Revenue Act of 1921—

> The allowance of anything beyond an actual loss would be most unlikely in the absence of a clear legislative mandate. The provision in section 214 (a) (6) that losses are to be computed upon the basis of the "fair market price or value as of March 1, 1913," should be construed, like other similar clauses, as merely a limitation upon losses that would otherwise have been deductible. While Congress can, of course, allow such deductions as it pleases and limit them as it will, it can not reasonably be thought to have intended in any case to have allowed more than actual losses * * *.

In *George DeBeck v. Commissioner* (23 B. T. A., 710, acquiescence, C. B. XI-1, 2), the Board said:

> The Treible decision in effect holds that in determining the loss sustained from the sale of property originally acquired as a residence and later converted into business property, the rule is to compute the amount of the loss, first, in accordance with the applicable statute dealing with the computation of gain or loss from the sale or other disposition of property, and, second, to allow as a deduction only that portion of the loss so determined as occurred subsequent to the time the property was converted into business use.
>
> * * * * * *
>
> It is our opinion that the instant case is controlled by section 204 (b), supra, and that the value in 1916 should be used only as a limitation upon the actual loss prescribed by the statute. * * *

In *Charles J. Thatcher v. Commissioner* (24 B. T. A. 1130) the Board said:

> * * * When residential property is converted into business property, it is the fair market value of the property at the time of conversion which represents the cost of the business property. * * *

The above reasoning has been carried into article 23 (e)-1 of Regulations 86 in interpreting section 23 (e) of the Revenue Act of 1934. That article provides in part as follows:

> *Losses by individuals.*—* * *
>
> * * * * * *
>
> * * * If, however, property so purchased or constructed is prior to its sale rented or otherwise appropriated to income-producing purposes and is used for such

purposes up to the time of the sale, a loss from the sale of the property, computed as provided in section 111, is, subject to the limitations provided in section 117, an allowable deduction in an amount not to exceed the excess of the cost or other basis of the property at the time it was appropriated to income-producing purposes (with proper adjustment for depreciation) over the amount realized from the sale. [Italics supplied.]

The example set forth in article 23 (e)-1 shows clearly a computation wherein the allowable loss is limited to the actual loss sustained, based upon the value of the property when converted to income-producing purposes, although the provisions of section 23 (h) are equally applicable.

Section 23 (e) 3 of the Revenue Act of 1934 allows as a deduction certain losses sustained during the taxable year, including losses arising from "other casualty." Such losses must be *actually sustained*. In such a case it is not the purchase price of the property which is lost but the value of the property at the time of the casualty. It is the opinion of this office that the provisions of section 23 (e) 3 are controlling with regard to the deductibility of such losses by individuals, and that such losses are limited thereby to the amount of loss *actually sustained*; and that section 23 (h) which provides that a loss must be determined or measured by the adjusted basis is a limitation provision. Therefore, although computation must be made in accordance with section 23 (h) and section 113, the amount deductible is the loss *actually sustained*, and not in excess of the amount computed under section 113. As stated above, this view was adopted

in Regulations 65 and is clearly set forth in the example relating to loss from sale of property purchased as a residence but later converted to income-producing purposes.

In the present case the taxpayer's automobile was valued just prior to the collision at [illegible]x dollars. Just after the collision its value was only 1,07x dollars. The loss actually sustained as a result of the collision was, therefore, the difference between those amounts, or 2,53x dollars. Since that amount is not in excess of the amount computed under section 118, it follows that 2,53x dollars is the amount of the loss allowable as a deduction under section 23 (e) 3.

In view of the fact that the position adopted herein is not in accord with the conclusion reached in I. T. 2217 (C. B. IV–2, 53) that upon the destruction of a residence by fire in the year 1924 the deductible loss sustained was the difference between the cost of the property (without any adjustment for depreciation) and the insurance or other compensation received, reduced by the salvage value, if any, of the property, or with the conclusion reached in I. T. 2231 (C. B. IV–2, 53) that the amount of a loss sustained by a taxpayer through the bursting of a boiler used in the heating of his residence is the difference between the basis of the boiler and the insurance or other compensation received, reduced by the salvage value of the boiler, if any, it is recommended that I. T. 2217 and I. T. 2231 be modified accordingly.

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